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**DIRECTORATE OF INTELLIGENCE**

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South Korea: Grappling With Import Liberalization [redacted]

Summary

South Korea's recently announced import liberalization program is part of a broad effort by many of the country's leading economic officials to open the economy by reducing government intervention and relying more on market forces. Several interest groups oppose the program, and its ambitious target--lowering South Korea's level of protection to developed country standards by 1988--could be undermined by the same special exceptions and tariff barriers that have muted the impact of earlier liberalization efforts. Nonetheless, the growing belief within the government that reduced protection will strengthen South Korean industrial competitiveness, in our judgment, will result in a selective but meaningful relaxation of import barriers by the late 1980s. [redacted]

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This memorandum was prepared by [redacted] Korea Branch, Northeast Asia Division, Office of East Asian Analysis. Information available as of 6 April 1984. Comments and queries are welcome and may be directed to the Chief, Korea Branch, Northeast Asia Division, OEA [redacted]

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### The Liberalization Program

The import liberalization program announced between December 1983 and February 1984 has as its goal a phased reduction in both tariff and nontariff protection over the next five years. Initially, many commodities will be freed from nontariff protection but will be subjected to higher tariffs. By the late 1980s tariffs are also to be reduced. [redacted]

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More than 1,500 items now require prior approval from a concerned private trade organization or a government ministry before they can be imported, and in practice, approvals are rarely granted. Machine tool imports, for example, must be approved by the Korea Machine Tool Industry Association. In addition, numerous commodities can only be imported after the Ministry of Commerce and Industry (MCI) enacts separate regulations. Razors and razor blade imports, for example, are subject to separate regulations but the MCI does not intend to promulgate them until 1986. [redacted]

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Even commodities on the government's automatic approval list are not all freely imported. Many are subject to a surveillance system, under which additional imports are banned once certain levels are exceeded. Although 80 percent of all trade items are currently on the automatic approval list and Seoul plans to increase this to 95 percent by 1988, we estimate that other barriers--including special tariffs--reduce the real number of items freely imported to about 60 to 65 percent. Mirroring government priorities, barriers are weighted toward protecting small- and medium-sized firms, infant industries (electronics, machine tools, transport equipment), and farm interests. Consumer goods are tightly restricted because of balance-of-payments concerns. South Korea has traditionally run large current account deficits. [redacted]

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Seoul also plans to reduce tariff rates to average developed-country levels by 1988, from the current average of 23 percent to 17 percent. The government, however, will retain an emergency tariff system allowing it to raise tariffs up to 40 percentage points above general rates for six months on selected commodities, which may also be subject to nontariff protection. In addition, an adjustment tariff system was introduced with the liberalization program, allowing Seoul to impose tariffs of up to 100 percent on products freed from nontariff protection. [redacted]

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### The Progress of Liberalization Efforts

Seoul maintained a broadly restrictive import control system until the late 1970s when it removed restrictions from many raw materials and capital goods not produced domestically. The

primary goal of the change was to slow the country's high inflation rate by increasing the supply of foreign goods. Strengthening industrial competitiveness and meeting the complaints of trading partners were secondary objectives. [ ]

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Although Seoul at that time raised the number of items on the automatic approval list from about 50 percent to 68 percent, most commodities freed from protection did not compete with domestic producers. We believe that the 77-percent surge in import volume that occurred in the 1977-79 period primarily reflected a domestic investment boom not the trade liberalization. The liberalization program, nonetheless, probably contributed to some of the increase in foreign purchases, perhaps adding several hundred million dollars to the import bill. Following the second oil shock in 1979, Seoul froze further liberalization. [ ]

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Since 1982, top economic officials have made import liberalization a top priority. Kim Jae-ik, the former Blue House Senior Secretary for Economic Affairs, was in the forefront of this effort until his death in the Rangoon bombing last October. Finance Minister Kim Mahn Je, Deputy Prime Minister Shin Byong Hyun, Presidential Secretary General Kang Kyong Shik, Senior Secretary for Economic Affairs Sakong Il, and Overseas Cooperation Council Director Kim Ki Hwan are now the prime movers. Most of these officials were educated in the United States and they are convinced that opening the import market will strengthen the economy. They link trade liberalization to efforts to reduce government intervention in the economy and rely more on market forces. (They also seek to reform the financial sector and to ease foreign investment regulations.) [ ]

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They argue that reductions in import protection will:

- Force South Korean industry to increase efficiency, upgrade quality, and boost technology levels, becoming more competitive in world markets.
- Help defuse protectionist sentiments in developed countries. Several countries, including the United States, have linked South Korean access to their markets to a reduction in Seoul's import barriers. [ ]

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Ranged against these liberalizers are the Ministries of Commerce and Industry, Agriculture and Fisheries, businessmen, and farm groups. They are concerned that many domestic producers cannot compete with foreign goods and will go bankrupt. [ ]

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These interest groups have used their political clout to ensure that import barriers are removed gradually. They have

succeeded in limiting the number of commodities freed from restrictions and have argued successfully to have higher tariffs imposed on many products freed from nontariff protection. [redacted]

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A favorite tactic of these groups is to keep protection on the market segment where demand is greatest while agreeing to lift barriers from the subcategories where demand is small or nonexistent. Seoul, for example, moved carpets and rugs--certain wool and acrylic types--to the automatic approval list in 1983 but left in force subcategories where almost all the demand existed--i.e., nylon carpets. The same tactic was used in "liberalizing" loudspeakers--only those under 5 inches in diameter were moved to the automatic approval list. This tactic is also used for computer equipment, cameras, and fabrics. [redacted]

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The protectionists have also used special laws related to health or safety standards to ease the impact of liberalization. Refrigerators, for example, were "liberalized" but are subject to an "electric supplies safety control law" enforced by a division within the Ministry of Commerce and Industry. Through this tactic, Seoul bans refrigerators as not being up to Korean standards. For glassware, limits on the size or value of shipments are so low that exporters cannot afford to compete in the market--a trader can only get a license for up to \$10,000 every 15 days. [redacted]

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#### Impact on Imports

Such tactics have caused the liberalization program to be long on rhetoric and short on substance. Although Seoul has shifted hundreds of items to the automatic approval list since 1982, it has chosen products in which South Korea has a strong competitive advantage. In last year's trade plan, for example, textile products accounted for about 35 percent of all items freed from nontariff protection. Since 1982, Seoul also has placed almost 200 commodities on the surveillance list, giving the government the option of banning the import of these goods if their share of the market grows too rapidly. In addition, about 100 items freed from nontariff protection last year were subjected to higher tariffs. The tariff on cosmetic soaps, for example, was hiked from 30 to 70 percent (see table 1). An additional constraint is that some commodities--cosmetics are an example--can only be imported by domestic producers of the product. [redacted]

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As a result of such measures, imports of most items freed from nontariff protection have remained negligible--generally less than \$1 million annually per commodity, according to our analysis. We have identified only a few cases in which purchases

of foreign goods have risen substantially following liberalization. These are primarily subcomponents and equipment needed to produce export goods and products that embody special technology, for example, ship parts, electronic switching system equipment, and selected semiconductor parts (see table 2). [redacted]

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### Outlook

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Despite Seoul's unimpressive record on liberalization, we believe its new long-term plan will result in some easing of protection by 1988. The key argument of the liberalizers--namely that greater reliance on market forces will benefit the Korean economy--is gaining wider acceptance within the bureaucracy. The post-Rangoon cabinet is heavily weighted with proponents of liberalization, and we believe their influence is on the rise. They have, for example, recently pushed through policies that are prerequisites for opening the banking and foreign investment sectors to greater competition. In addition, pressure from the United States at recent economic meetings, in our view, has convinced the Chun government that it must deliver "true" import liberalization to avoid serious trade problems with Washington.

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We anticipate that Seoul will continue to focus on removing barriers from commodities that South Korea can manufacture most competitively--such as textiles--and from those needed for generating exports goods--such as machinery. We believe consumer goods, which are currently tightly restricted, will also be imported more freely by 1988. [redacted]

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Seoul will remain reluctant to remove protection from its emerging industries--electronics, machine tools, and autos. In our judgment, farm products are the least likely to be freed from protection, largely because of political considerations. The rural sector is an important source of support for the government and farm interests are strongly represented in the National Assembly. Seoul is also concerned about maintaining urban-rural income equality. [redacted]

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In our view, forward movement will be steady but cautious. Seoul will continue to use the surveillance system and special tariffs to control the pace of liberalization. We believe several factors will determine the speed of "true" liberalization. South Korea's balance-of-payments position and access to foreign capital are probably the most important variables. An improved current account would make it easier for Seoul to remove import barriers; coping with balance-of-payments problems, on the other hand, would take precedence over import liberalization. Seoul, with a \$40 billion foreign debt, would

face a serious problem meeting its foreign financial obligations if exports slump or bankers lose confidence in Seoul's repayment capabilities. [REDACTED]

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The speed with which South Korea's emerging industries reach international competitiveness will dictate how fast barriers are removed from many industrial commodities. Even the proponents of liberalization believe that these industries need some breathing space. [REDACTED]

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US pressure will also be important. Seoul is sensitive to Washington's concerns and attaches high priority to maintaining good relations and avoiding the type of trade problems that have bothered US-Japanese relations. Seoul, in fact, has encouraged private firms to favor US suppliers whenever possible and the US share of the Korean market has risen appreciably in recent years. [REDACTED]

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Finally, the level of protectionism in developed countries will play a role. Seoul will need to be able to point to a lessening in overseas barriers to justify to its public the removal of its own controls. [REDACTED]

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Table 1

## Tariff Hikes for Selected Liberalized Items, July 1983

<u>Commodity</u>	<u>Previous Rate (%)</u>	<u>New Rate (%)</u>
Ice Cream	50	90
Electric Refrigerators	50	90
Washing Machines	50	90
Alarm Clocks	50	90
Lorries and Vans	50	90
Ties	50	80
Sweaters	50	70
Nightwear	50	70
Yarn	50	70
Outergarments	50	70
Bicycles	50	70

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Table 2

Imports of Selected Items Liberalized During 1982 and 1983  
(Value in \$1,000 US-monthly average)<sup>1</sup>

<u>Commodity</u>	<u>Before Liberalization</u>	<u>After</u>
Polyester fibers	7	135
Acrylic fibers	67	36
Polypropylene fibers	0	0
Viscose rayon fibers	2	2
Pile and chenille fabrics of polyester fiber	19	15
Pile and chenille fabrics of acrylic fiber	67	63
Pile and chenille fabrics of other man-made fibers	8	12
Pile and chenille fabrics of silk	0	0
Pile and chenille fabrics of other fibers	0	3
Knitted fabrics of acrylic fibers	72	37
Knitted fabrics of acetate filament yarn	13	23
Knitted fabrics of regenerated fibers	0	3
Diamonds, industrial use	0	0
Semi-precious stones for machinery	128	178
Electric motors	141	83
Transformers	56	94
Voltage Regulators	89	105
Rectifiers	62	166
Sound Equipment	156	193
Locker Shovel	399	2,577
Semi-conductor parts	9,346	11,210
Electronic switching systems	11,455	16,503
Parts of rotary connectors	6	81
Parts of dairy equipment	15	12
Parts of heat exchangers	453	89
Parts of boilers	4	6

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<sup>1</sup> Average Computed based on imports for 6 to 12 month periods  
before and after liberalization.



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